

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

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REPLY BRIEF OF  
ALLIANCE OF NONPROFIT MAILERS  
AMERICAN BUSINESS MEDIA  
COALITION OF RELIGIOUS PRESS ASSOCIATIONS  
DOW JONES & COMPANY, INC.  
MAGAZINE PUBLISHERS OF AMERICA, INC.  
NATIONAL NEWSPAPER ASSOCIATION  
THE MCGRAW-HILL COMPANIES, INC.  
TIME WARNER, INC.

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September 22, 2000

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**REPLY BRIEF OF  
PERIODICALS MAILERS**

**I. INTRODUCTION**

The Governors of the United States Postal Service filed the Docket No. R2000-1 rate request before implementation plans for the initiatives recommended by the joint industry/Postal Service Periodicals Operation Review Team were finalized and the resulting savings from these initiatives could be fully quantified.<sup>1</sup> The timing of this decision accounted for much of the unexpectedly large 14-16 percent average increase proposed for Periodicals in the original request. Periodicals Mailers<sup>2</sup> had expected a requested Periodicals increase that did not, on average, exceed "single digits."

Fortunately, encouraged by the Postal Rate Commission, which on March 28 asked the Postal Service to "present detailed evidence explaining the causes of the trend in cost of processing Periodicals," PRC Order No. 1289

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<sup>1</sup> The Team's findings and recommendations are set forth in the Report of the Periodicals Operations Review Team, USPS-LR-I-193 (Team Report). Witness O'Brien discusses them in detail. Tr. 24/11166-95.

<sup>2</sup> "Periodicals Mailers" refers to the parties sponsoring this brief.

(March 28, 2000) at 1, the Postal Service continued to work with the periodicals industry to implement cost reduction initiatives and quantify the resulting savings that will be achieved by Test Year 2001. These savings are now fully documented on this record and in large part are unchallenged and unrefuted. As a result of these savings and other cost reductions established on the record, a much smaller Periodicals rate increase is required than was originally requested. Indeed, the Postal Service now says that “[t]he expectation is that, when all the cost adjustments are finalized, a rate increase of less than 10 percent for Periodicals would be possible.” Postal Service Initial Brief at I-24. “Postal Service witness Taufique testified that he expected that the lower increase would be approved by the Postal Service.” *Id. citing* Tr. 43/18775. Periodicals Mailers assert that the record as it now stands will not permit a recommended average increase for Periodicals that is greater than the system-wide average. Periodicals Mailers Initial Brief at 2. In the sections that follow, we summarize the savings and reductions that support this result.

Periodicals Mailers recognize that this is a particularly complicated proceeding in which the Commission has repeatedly and correctly pressed to ensure that the record contains the best available data on which to base its recommended decision. The Commission’s efforts helped produce a record that now contains evidence of the Periodicals cost savings and reductions described below.

## **II. AGREED UPON COST SAVINGS, REDUCTIONS AND REDISTRIBUTIONS**

In this section we summarize the cost savings and reductions supported on the record and identify those that are unrefuted and unchallenged (and in many cases agreed upon or acknowledged by the Postal Service). Additional cost savings and reductions are discussed in Part III.

### **A. Cost Savings and Reductions That Are Agreed Upon, Acknowledged, or Unchallenged Total \$169 Million**

The following Test Year 2001 cost savings and reductions are now agreed upon, acknowledged or unchallenged by the Postal Service. These savings total \$169 million in Test Year 2001. None is challenged by any party on the record, and they will therefore not be addressed further here.<sup>3</sup>

- Savings associated with requiring preparation of basic carrier route Periodicals in line-of-travel sequence – \$23 million. Periodicals Mailers Initial Brief at 7; Postal Service Initial Brief at VII-139-140; Tr. 21/8947; USPS-LR-I-307.
- Savings associated with changes in other Periodicals mail preparation requirements involving (a) mandatory compliance with the L001 option, (b) elimination of carrier route sacks with fewer than 24 pieces, and (c) allowing barcoded and non-barcoded bundles in the same sack – \$15 million. Periodicals Mailers Initial Brief at 8; Postal Service Initial Brief at VII-140-141; Tr. 46-D/21512-14; USPS-LR-332.
- Savings associated with efforts underway to reduce bundle breakage – \$15 million. Periodicals Mailers Initial Brief at 12-14;

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<sup>3</sup> Periodicals Mailers also decided against including further argument on the subject of purchased highway transportation contracting procedures, improvement in which Nelson estimated would result in savings of \$6 million in the Test Year. Though disputing Nelson's methodology in its initial brief, the Postal Service nevertheless has identified \$12 million in Periodicals savings as a result of breakthrough productivity in highway transportation. Postal Service initial brief at V-150, n. 11. We accept the Postal Service's savings estimates.

Postal Service Initial Brief at VII-141; Tr. 46-D/21515-18, 21521; Tr. 5/1705.<sup>4</sup>

- Savings associated with various mail processing enhancements involving (a) increased flat sorting productivity, (b) better AFSM 100 performance, and (c) addition of OCRs and automatic feeders to the FSM 1000 – \$47 million. Periodicals Mailers Initial Brief at 9-10; Postal Service Initial Brief at VII-141-142; Tr. 46-C/20961-62, 20872-75; Tr. 46-D/21519-20.<sup>5</sup>
- Savings associated with a work methods change embodied in a Memorandum of Understanding with the National Association of Letter Carriers – \$7 million. Periodicals Mailers Initial Brief at 9; Postal Service Initial Brief at 142; Tr. 46-C/20958-59.
- Savings associated with reduced use of air transportation for Periodicals – \$11 million. Periodicals Mailers Initial Brief at 10.<sup>6</sup>
- Savings associated with breakthrough productivity in highway transportation – \$12 million. Periodicals Mailers Initial Brief at 11.<sup>7</sup>
- Savings associated with a final adjustment to Test Year Periodicals costs to ensure that the mail mix used for estimating Periodicals costs is consistent with the mail mix used to estimate Periodicals revenue – \$39 million. Periodicals Mailers Initial Brief at 17-19; Postal Service Initial Brief at I-23-24; Tr. 38/17077-78.

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<sup>4</sup> As we stated in our initial brief, Test Year savings associated with reduced bundle breakage will exceed those acknowledged by the Postal Service by \$6 million. Periodicals Mailers Initial Brief at 12-14; Tr. 24/11235-36.

<sup>5</sup> The Postal Service believes these cost savings should be used if the Commission uses FY 1999 as the base year and did include them in its response to Order No. 1294. Tr. 46-C/20872-75.

<sup>6</sup> As stated in our initial brief, this cost reduction should only be used if the Commission uses FY 1998 as the base year.

<sup>7</sup> The Postal Service believes these cost savings should be used if the Commission uses FY 1999 as the base year and did include them in its response to Order No. 1294. Tr. 46-C/20872-75.

**B. There are Additional Cost Reductions that Result from Agreed Upon Refinements in Base Year Costing Methodologies That Reduce Base Year Periodicals Costs by \$137 Million**

The Postal Service has noted that “the joint Postal Service/Periodicals effort resulted in identification of a number of refinements to base year costing methodologies which would lead to reduced Periodicals costs.” Postal Service Initial Brief at VII-142. The Postal Service in its brief urges the Commission to adopt all of these costing methodology changes. *Id.* at VII-144. These refinements, which reduce base year Periodicals costs by a total of \$137 million, are as follows:

- Reductions associated with a change in the distribution of mixed mail costs – \$17 million. Postal Service Initial Brief at VII 142-143; Periodicals Mailers Initial Brief at 22-25; USPS-LR-I-313.
- Reductions associated with a change in the rural carrier mail shape adjustment – \$17 million. Postal Service Initial Brief at VII-143; Periodicals Mailers Initial Brief at 29; Tr. 46-C/20840; USPS-LR-I-335; Tr. 39/17777; USPS-LR-I-450.
- Reductions associated with witness Baron’s estimated new route-level regressions for load time variability – \$50 million. Postal Service Initial Brief at VII-143; Periodicals Mailers Initial Brief at 30-31; Tr. 43/18695-96; USPS-LR-I-402 and 405; see also Joint Brief Concerning City Carrier Cost Attribution.
- Reductions associated with setting the variability for loop/dismount costs at zero – \$46 million. Postal Service Initial Brief at VII-143; Periodicals Mailers Initial Brief at 31; Tr. 43/18723-28; USPS-LR-I-450.
- Reductions associated with a new distribution key for Amtrak Roadrailer costs – \$2 million. Postal Service Initial Brief at VII-143; Periodicals Mailers Initial Brief at 34-35; Tr. 43/18531; USPS-LR-I 432 and 433.
- Savings associated with a revised distribution key for rail empty equipment costs – \$5 million. Postal Service Initial Brief at VII-144; Periodicals Mailers Initial Brief at 35-36; Tr. 38/13414.



### **C. Cost Reduction Summary – \$306 Million**

Periodicals Mailers have identified and discussed more than \$306 million in cost savings, reductions and redistributions agreed to on the record that support a substantially smaller recommended increase for Periodicals than the increase originally requested by the Postal Service. We have pointed out that these savings, reductions and redistributions are unchallenged and unrefuted. And, we maintain that these savings, reductions and distributions, without consideration of any other issues, form the basis for a recommended average rate increase for Periodicals that is no larger than the system-wide average for all mail.

### **III. OTHER COST SAVINGS, REDUCTIONS AND DISTRIBUTIONS SUPPORTED ON THE RECORD IN ADDITION TO THOSE AGREED UPON, ACKNOWLEDGED, OR UNCHALLENGED TOTAL SEVERAL HUNDRED MILLION DOLLARS**

In this part, we address cost savings and redistributions as to which there is disagreement.

#### **A. Cost Savings and Reductions**

In addition to cost savings and reductions that are agreed upon, acknowledged, or unchallenged, Periodicals Mailers have established that the following cost savings or reductions totalling \$48 million could be achieved in the test year:<sup>8</sup>

- Savings associated with introduction of the AFSM 100 in addition to those acknowledged by the Postal Service and savings associated with correcting the Postal Service's method for rolling forward

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<sup>8</sup> This figure includes the \$6 million in additional savings from reduced bundle breakage.

supervisory costs – \$27 million. Periodicals Mailers Initial Brief at 14, 16-17.

- Savings associated with elimination of the AMTRAK premium – \$15 million. Periodicals Mailers Initial Brief at 14-15.

**1. AFSM 100 Savings Have Been Understated, and Supervisor Costs Have Been Overstated**

In its initial brief, the Postal Service is critical of DMA witness Buc's proposed corrections to the cost reduction programs for supervisors and for the AFSM 100. Postal Service Initial Brief at II-26-27. The Joint Brief Concerning the Revenue Requirement of DMA, *et al.*, and the reply brief of these parties (which includes Periodicals Mailers) refute the criticisms of Buc's analysis raised in the Service's initial brief.

Notwithstanding these facts, we find it important to comment on one particular criticism of the Postal Service. Its initial brief states, "Witness Patelunas explained that witness Buc's mechanical application of reduced supervisors' costs does not reflect the program managers' expert assessment of the level of supervisor savings that can or can not be captured in connection with each cost reduction program." Postal Service Initial Brief at II-27. And while the brief does not contain the same criticism for witness Buc's estimate of cost savings, it is important to remember that Postal Service program managers' expert assessments are the basis of the cost savings estimate for the AFSM 100. Simply stated then, the issue becomes, "When should program managers' expert judgment be used in cost forecasting?"

Recall that the rollforward program has eight sources of change: cost level, mail volume, additional workday, non-volume workload, cost reduction

programs, other programs, workyear mix adjustments, and final adjustment. (USPS-T-9 at 11-17). The Postal Service uses program managers' expert judgment only in forecasting cost reductions and other program costs. What this means is that, if the Test Year is estimated to have five percent less mail than the previous year for a particular subclass, the Postal Service does not ask program managers whether the savings can be captured. If fuel costs are projected to decline in the Test Year, the Postal Service does not ask program managers whether the savings can be captured. And if there is one less workday in the Test Year than in the previous year, the Postal Service does not ask program managers whether the savings can be captured. Instead, the Postal Service's cost estimates rely on quantitative methods for these six sources of change.

This is because quantitative and objective methods provide a method of estimating test year costs superior to merely relying on program managers' expert judgment. When a witness uses objective and quantitative methods, other intervenors and the Commission can explore the underlying assumptions, the data, and the method. When the assumptions are reasonable, the data are not controversial, and the method correct, a quantitative approach is clearly superior to expert judgment. If they are not, the estimate can be adjusted to make them so. Therefore, the Rate Commission should accept expert judgment only when there is no alternative. In this instance, witness Buc has provided a superior cost estimate based on quantitative methods. This is clearly an improvement over the Postal Service's judgmental estimate.

**2. Eliminating the Amtrak "Premium" Would Result in Savings of \$15 Million**

Witness Nelson has testified that the Postal Service pays a "premium" to Amtrak on "Amtrak segments where the payments to Amtrak exceed the cost of purchased highway transportation." Tr. 28/13419. By negotiating "more vigorously" with Amtrak to obtain better rates and/or by converting the higher-cost Amtrak segments to truck transportation, witness Nelson stated, USPS could achieve \$15 million in annual savings for Periodicals by the Test Year. Tr. 28/13420.

The Postal Service disagrees, claiming (without any citation to the record) that truck transportation for the segments might not be "equivalent" or "readily available," that it does not know how much such transportation would cost, that service might be jeopardized, and that it has no idea how much the cost would be "of letting all of the new contracts that would be required." Postal Service Initial Brief at V-144. Additionally, it argues, Nelson's calculation of the premium omits "both Amtrak movements of 30 feet or less and Amtrak movements that cost less than comparable highway movements." Postal Service Initial Brief at V-145. It does not state what, if any, effect the "omission" of the "movements of 30 feet or less" had on witness Nelson's calculation. The Service also does not address the question of why witness Nelson should have included "Amtrak movements that cost less than comparable highway movements" in his study and proposals regarding those segments that cost *more*. (In fact, the vigor of its arguments regarding witness Nelson's premium calculations notwithstanding, the Postal Service has acknowledged that it simply *does not know* whether what it is

paying Amtrak is more than what it would have to pay for highway transportation of the same mail. Tr. 43/18542.)

Further, the Service claims, witness Nelson's calculation of the Amtrak premium is flawed because it is "based" only on replacing rail service with highway transportation purchased through "lower-cost non-renewal contracts." Postal Service Initial Brief at V-145. But, in fact, it is the Postal Service's reasoning that is flawed. If the Postal Service does not have spare capacity to transport volumes that might shift from Amtrak to trucks, then, as Nelson assumed, all Amtrak capacity would have to be replaced with new highway capacity. This capacity, by definition, would be at nonrenewal rates. If, on the other hand, the Postal Service has enough unused capacity to move significant volumes of Amtrak mail on existing contracts, then witness Nelson actually understated the Amtrak "premium," because the Postal Service would need to procure less new highway capacity than calculated by Nelson. Nelson's use of 100% replacement and nonrenewal highway rates is the only internally consistent analysis on the record.

The Postal Service also argues that witness Nelson's calculation of the Amtrak premium is wrong because it does not take into "account the cost of returning highway trailers to the origin point." Postal Service Initial Brief at V-145. Yet, truckers manage to return trailers (without being paid two-way charges by one-way shippers) all the time, and no postal rule or regulation would prohibit them from carrying mail in one direction and other commodities in the other. Tr. 43/18551-52 and Tr. 43/18556-57; Tr. 43/18604, 18607.

## **B. Redistributions and Variability**

### **1. Mail Processing Costs**

Periodicals Mailers continue to have fundamental disagreements with the Postal Service regarding the reliability of the IOCS/MODS based system of distributing mail processing costs and the need to radically redesign that system. Regarding what realistically can be done in this case using the data that do exist, a review of the Postal Service's brief shows that there has been a considerable convergence of views on many issues.

- a. There is More Agreement Between Parties Than Ever Before That Costs for Allied Operations Should Be Distributed to Subclasses Using a Broad Key, and Costs in Piece-Distribution Operations Should be Distributed Using a Narrow Key**

In this proceeding, three parties have testified regarding the appropriate method for distributing mail processing costs to subclasses of mail: Periodicals Mailers, the Postal Service, and United Parcel Service (UPS). As we stated in our initial brief, the distribution methods proposed by these parties are surprisingly similar in that they all include a broad distribution of allied costs and a narrow distribution of costs in piece-distribution operations.

The Postal Service and UPS initial briefs provide further support for the conclusion we drew in our initial brief. The Postal Service states, "witness Degen clearly supports the broad distribution of allied not-handling costs for the reasons he originally gave" and it urged the Commission to adopt "the unopposed distribution of allied not-handling costs." Postal Service Initial Brief at V-67. UPS indicates strong support for this proposal, stating that the Commission's Docket

No. R97-1 method “should be applied again in this proceeding, with the additional improvements proposed by Postal Service witnesses Degen and Van-Ty-Smith.” UPS Initial Brief at 28.

Because all parties that testified in this proceeding regarding the appropriate method for distributing mail processing costs to subclasses of mail support a broad distribution of allied costs, we submit that the Commission should continue to support this method as well. Furthermore, for the reasons specified in our initial brief, the Commission should distribute allied mixed mail and not handling costs broadly, using the particular method proposed by Periodicals Mailers witnesses Cohen, Stralberg, and Glick.

**b. IOCS Question 18 and 19 Data Should Not Be Ignored**

Nevertheless, we still have strong disagreements with the Postal Service regarding (1) the likelihood of bias in some parts of the IOCS data, particularly item and container type information collected at “allied” cost pools; and (2) the need to include useful IOCS information for which there is little likelihood of bias and that can affect cost distribution. While these issues were already addressed in our initial brief, we believe a few comments are necessary regarding two types of IOCS data that the Postal Service, and witness Degen in particular, continue to insist should be ignored.

**i. Migrated Window Service Costs**

The Postal Service continues to claim that when an employee clocked into a mail processing MODS number is observed by an IOCS clerk as “not handling mail” at a postal window, then the associated costs should be treated as if the

clerk had not been at the window, but in the processing operation indicated by the MODS number. In other words, according to the Postal Service, the specific Question 18 data indicating, for example, that this employee was selling stamps, setting meters, etc., should simply be ignored.

Arguments given in favor of ignoring this information rest mostly on witness Degen's unverified claim that clerks cannot work at postal windows unless authorized to handle at least \$50,000.00 worth of stamps. Therefore, Degen's theory goes, employees observed at postal windows while clocked into a mail processing pool must have been there only for some incidental purpose, e.g., to fetch mail entered through the window and bring it to the mail processing work area.

Degen's theory fails to explain the very specific window related activity codes associated with the "migrated" tallies, which demonstrate that the presence of these employees at postal windows was not just incidental. It also fails to explain why one today can buy stamps almost anywhere from non-postal grocery clerks that obviously do not have \$50,000.00 worth of such stamps. And it fails to explain why a DDU manager would not intentionally make sure that some of his employees are trained in both mail processing and window service or administrative work, thereby gaining flexibility in the use of available employees.

In any case, regardless of what type of window work these migrated employees may have been engaged in, whether they were selling stamps, setting postal meters, or simply waiting to take some mail entered through the window to mail processing, they were serving the type of mail that is entered



through postal windows, and the cost of their time should be attributed accordingly.

**ii. Question 19 Data**

Only a few points need to be added to the already extensive explanation in Stralberg's testimony (Tr. 24/11344, *et seq.*) and our initial brief (at 26-27) as to why use of Question 19 data, when available, can enhance the IOCS based distribution of mail processing costs.

As its initial brief shows, the Postal Service views the proposal to use this extra information exclusively as an alternative to the use of item and container information collected for mixed mail tallies. It is true that for many, though not all, mixed mail tallies, mail shape can be inferred from item/container data. But the vast majority of tallies for which Stralberg proposes to use the Question 19 data are either not handling or empty container tallies, for which no other shape related information exists. The information obtained from Question 19 is particularly useful in the distribution of Function 4 cost pools such as the LD43 pool.

There remains the question of whether or not the item/container information collected on allied mixed mail tallies should be used, given the substantial potential for bias in that information. But whether it is used or not, additional useful information on some tallies can be obtained by using the Question 19 data when available for not handling and empty container tallies.

Rather than discarding the limited information it has available to link some not handling and empty container tallies to specific mail shapes, the Postal

Service should look for ways to augment its current IOCS data collection scheme so as to be able in the future to link more tallies to shape and other relevant mail piece characteristics.

**c. The Assumption That Mail Processing Costs are 100 Percent Volume-Variable is Factually and Legally Untenable**

Mail processing cost pools can no longer be treated as 100% volume variable (*i.e.*, composed totally of attributable costs) because: (1) the Postal Service and Periodicals Mailers have presented substantial evidence — indeed, compelling and effectively unrebutted evidence — showing less than 100% volume variability; and (2) under *National Ass'n of Greeting Card Publishers v. USPS*, 462 U.S. 810, 827 (1983) ("*NAGCP IV*"), postal costs should in any event be treated as institutional costs absent substantial evidence that they are volume-variable or are otherwise attributable to particular classes of mail. See Initial Brief of Periodicals Mailers at 40-41. We address these two points in reverse order in responding to arguments presented by OCA and UPS.

**i. Under *NAGCP IV*, OCA and UPS Have the Burden of Proof, Which Is Not Obviated by the Commission's Past Assumption That Mail Processing Labor Costs Are 100 Percent Volume-Variable**

Under *NAGCP IV*, the burden is upon OCA and UPS to prove their contention that mail processing labor costs are 100 percent volume-variable (*i.e.*, that there are no economies of scale, and that changes in mail volumes therefore do not affect mail processing costs per piece of mail). There is no burden on the

Postal Service or Periodicals Mailers to disprove that counter-intuitive contention. In asserting otherwise, OCA overlooks the relevant holding in *NAGCP IV*.

OCA misplaces its reliance upon the following provision of the Administrative Procedure Act: “*Except as otherwise provided by statute*, the proponent of a rule or order has the burden of proof.” 5 U.S.C. §556(d) (emphasis added). In the present context, the governing statute, as construed by the Supreme Court in *NAGCP IV*, indeed provides otherwise. The Supreme Court held in *NAGCP IV* that “when causal analysis is limited by insufficient data, the statute [Postal Reorganization Act] envisions that the Rate Commission will ‘press for ... better data’, rather than ‘construct an ‘attribution’ ’ based on unsupported inferences of causation.” 462 U.S. at 827. See also *id.* at 834 (to the extent the data are not sufficient to establish a causal connection between postal costs and classes of mail, the Commission “is to assign [those] costs” as institutional costs).

Under *NAGCP IV*, therefore, a party contending that costs are volume-variable (attributable) has the burden of proving that contention. Inasmuch as OCA and UPS have failed to meet their burden, under *NAGCP IV* the costs in question cannot be treated as volume-variable (attributable) costs. If the Commission were to conclude that the evidence is insufficient to determine the extent to which such costs are volume-variable, under *NAGCP IV* the Commission should treat such costs as non-volume-variable (institutional) costs.

The Commission should not simply “assume” that any costs are volume-variable. *NAGCP IV* mandates precisely the opposite presumption — that the

costs are *not* volume-variable (attributable) — in the absence of substantial evidence showing otherwise. Contrary to the belief of OCA, it is irrelevant in this regard that prior to *NAGCP IV* and thereafter, the Commission nevertheless assumed that mail processing labor costs are 100 percent volume-variable. *NAGCP IV* is controlling, not the Commission's prior practice.<sup>9</sup> There is no need to disprove an assumption that is legally impermissible. To the extent that the Commission concluded otherwise in Docket No. R97-1, we respectfully submit that it erred as a matter of law.

**ii. The Postal Service and Periodicals Mailers Have in Any Event Proven That Mail Processing Labor Costs Are to a Significant Extent *Not* Volume-Variable**

It is telling that in its single-minded determination to maximize attributable costs, OCA relies primarily upon a bald assumption that mail processing labor costs are 100 percent volume-variable — asserting that any “underlying reasoning for the [assumption] is not at issue” (*id.* at 91) — and upon a purported burden on dissenting parties to prove otherwise. OCA is relegated to this defensive, legalistic posture because it cannot prevail factually. There is no substantial evidence of record that mail processing labor costs are 100 percent volume-variable,<sup>10</sup> and OCA does not seriously contend otherwise. Moreover, the Postal Service and Periodicals Mailers have indeed proven that those costs

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<sup>9</sup> OCA acknowledges that under *NAGCP IV*, “[i]f the costs attributed are not first reliably identified with a particular class under the methodology applied, then the . . . methodology does not meet the requirements of the [Postal Reorganization] Act.” Initial Brief of OCA at 92. However, OCA overlooks the fact that the Supreme Court imposed this standard on the *Commission* in *NAGCP IV*, not simply on the Postal Service, and held that costs are otherwise to be treated as institutional rather than attributable costs.

are to a significant extent *not* volume-variable, and thus not attributable to particular mail classes.

A simple but fully sufficient response to the inevitable criticisms of the volume-variability analysis presented by witnesses Bozzo, Degen, Greene, Cohen, Elliott, and Stralberg is that the “best must not become the enemy of the good, as it does when the [agency] delays making any determination while pursuing the perfect tariff.” *MCI Telecom. Corp. v. FCC*, 675 F.2d 408, 412 (D.C. Cir. 1982) (quoting *MCI Telecom. Corp. v. FCC*, 627 F.2d 322, 341-42 (D.C. Cir. 1980)).<sup>11</sup> This principle is applicable here, because the proposed methodology is clearly a quantum improvement over the existing “methodology” — which consists merely of a bare assumption unsupported by any evidence — and is manifestly superior to any alternative. See *MCI Telecom Corp.*, 675 F.2d at 414 (agency properly adopted “interim” cost-causation methodology because, despite its flaws, it was “an improvement over existing procedures” and was “superior to alternative proposals which can be implemented at this time”) (quoting agency).

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<sup>10</sup> See Postal Service Initial Brief at V-13-14, 21-27.

<sup>11</sup> See also *Edison Elec. Institute v. ICC*, 969 F.2d 1221, 1227 (D.C. Cir. 1992) (“The best should not be the enemy of the good. It is reasonable to assume that Congress did not intend the infeasible perfect to oust the feasible good”) (quoting *Commonwealth of Pennsylvania v. ICC*, 535 F.2d 91, 96 (D.C. Cir. 1976)). In *Edison Electric*, the Court held that the agency had properly adopted (in modified form) a refined version of methodology that it had previously rejected as having “grave” methodological problems.” *Id.* at 1223. The agency found that while the refined version did not cover a full business cycle and could well be inaccurate “in the longer run,” it nevertheless “largely satisfied [the agency’s] longstanding concern about accuracy.” *Id.* at 1224, 1226-27.

These principles have even greater force and dictate even greater flexibility in adopting imperfect methodologies that lead “in the right direction”<sup>12</sup> where, as here, the existing methodology is arbitrary or otherwise unacceptable, and/or the proposed methodology is seminal and subject to refinement in future proceedings. See, e.g., *AT&T Co. v. FCC*, 572 F.2d 17, 24 (D.C. Cir. 1978) (to the extent existing tariffs are found to be unreasonable, the agency “may institute broad policy changes while leaving for future proceedings the fine tuning of the rate structure”) (rejecting on this ground a contention that an agency decision was not supported by “substantial evidence”); *American Public Gas Ass’n v. FPC*, 567 F.2d 1016, 1031 (D.C. Cir. 1977) (agencies accorded particularly wide latitude in initially adopting methodology that “features novelty, in subject, technique, or both,” and is subject to future refinement).<sup>13</sup>

Under these controlling legal standards, the scattergun criticisms by OCA and UPS provide no valid basis for rejecting the volume-variability analysis presented by the Postal Service and Periodicals Mailers, which is based on a manifest improvement in methodology and is supported by substantial

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<sup>12</sup> *MCI Telecom. Corp. v. FCC*, 675 F.2d at 416 (cost allocation methodology properly adopted based on agency’s finding that it “might continue to underallocate costs to private line services, at the expense of message services, but that the effect on rates would be in the right direction”).

<sup>13</sup> See also *MCI Telecom. Corp. v. FCC*, 675 F.2d at 414 (agency properly adopted improved but flawed cost allocation methodology in view of agency’s intent to “continue the search for a cost allocation method which is optimal in theory and in practice”); *Edison Electric Institute v. ICC*, 969 F.2d at 1227 (agency properly adopted improved but flawed methodology in view of agency’s “on-going approach” to “incorporate more data into its analysis as they become available in the future”); cf. *National Ass’n of Reg. Util. Com’rs. v. FCC*, 737 F.2d 1095, 1147 (D.C. Cir. 1984) (“Perfection is attained by slow degrees; it requires the hand of time”).

evidence.<sup>14</sup> The Commission should at least adopt a modified version of the volume-variability estimates presented by Periodicals Mailers in their initial brief (at 44-49). The Commission should not default to an arbitrary and unsupported assumption — contrary to *NAGCP IV* — that mail processing costs are 100 percent volume-variable. Rather, the Commission should reject the implicit premise of OCA and UPS that the best is the enemy of the good and should embrace the improved methodology subject to fine-tuning in future proceedings.

Moreover, the only permissible alternative, under the Supreme Court's decision in *NAGCP IV*, is to treat the mail processing labor costs in question as institutional costs. Indeed, to accept the argument of UPS — that the MODS data are too unreliable to make any reasonable estimate of the volume-variability of mail processing labor costs — would mean that *all* such costs should be treated as institutional costs.<sup>15</sup> The *NAGCP IV* decision does not permit the Commission simply to assume, without substantial evidence, that all of those costs are volume-variable, or that any portion of those costs are volume-variable,

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<sup>14</sup> As witness Greene testified, while the data relied upon by witness Bozzo are "obviously far from perfect," they "appear to be quite good," indeed, "as good as an analyst of mail processing costs could hope for" (apart from a data set designed specifically for studying volume-variability). Tr. 46-E/22040. Dr. Greene further testified that while the criticisms by OCA and UPS "might provide useful guidance for refinement of the data" in the future (*id.* at 22039), they otherwise "raise a standard that could never be met." *Id.* at 22046.

<sup>15</sup> See Initial Brief of UPS at 17. However, the Postal Service has demonstrated that the MODS data are fully adequate for statistical variability analysis, that the vast majority of apparently anomalous MODS data were appropriately excluded from witness Bozzo's analysis, and that his results are not undermined by such data. See Postal Service Initial Brief at V-44-59. OCA asserts merely that there is "room for substantial improvement in the database," such that witness Bozzo's results "may be tentative." Initial Brief of OCA at 98. Even if that assertion were true, the Commission should accept those results as superior to any alternative — subject to fine-tuning in future proceedings — in accordance with the case law surveyed above. However, if the Commission were to agree with OCA that "witness Bozzo's methodology . . . does not reliably identify costs for attribution (nor, for that matter, does any other methodology applied in this

merely because it has done so in the past. In order to find that a portion of those costs are volume-variable (attributable) costs, the Commission should adopt the volume-variability analysis of witness Bozzo.

## **2. Carrier Costs**

Periodicals Mailers showed in their initial brief (at 30-31) and in the Joint Brief Concerning Attribution of Carrier Costs, in which they joined, that the Commission should reject the ES study for the purpose of attributing carrier costs. We also showed that, if the Commission does use the ES study for carrier cost attribution, it must also use the corresponding volume variabilities and accrued cost adjustments developed by Baron from the same data.

Both NAA and OCA argue that the Commission should use the ES to attribute city carrier out-of-office time. However, to derive the variability associated with the ES proportion of load time, both parties attack the ES route-level load time model presented by the Postal Service to match the ES estimate of accrued load time and state their preference for the use of the older, Load Time Variability (LTV) stop-level models, based on data collected in 1985.

As shown in detail in the Joint Reply Brief Concerning City Carrier Cost Attribution, NAA and OCA inconsistently, illogically and unpersuasively argue that the ES study is adequate for estimating proportions of carrier out-of-office time but not for estimating the variability of that time. They gloss over the fact that the ES estimates of load time have been proven to be far different from those for the LTV/STS (Street Time Survey) and, therefore, that the ES and LTV

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record)" (*id.* at 93), then under *NAGCP IV*, all mail processing labor costs should be treated as



data represent different sets of carrier activities. These parties are wrong, because there must be a proper matching of accrued times and variabilities associated with those times, or the result will be meaningless. Either the ES must be used for both accrued load time proportions and variabilities, or the combination of STS and LTV must be used.<sup>16</sup>

### **3. Purchased Highway Transportation**

Of the forty-nine pages it expends critiquing witness Nelson's "relentless ... search for cost savings," Postal Service Initial Brief at V-148, twenty-eight are devoted to a defense of witness Bradley's study of the variability of purchase highway transportation costs, with which both witness Nelson and United Parcel Service witness Neels have taken issue. Despite the length and breadth of the Postal Service's defense, however, several uncontravertable problems with Bradley's approach remain.

- Bradley's theory for relying on "mean-centering" to simplify the computation of variabilities has been refuted by Greene and Neels, and Neels asserts that Bradley's program does not correctly implement the computation that Bradley was trying to perform. See Tr. 46-E/22078-79, 21908, 21925-26. Furthermore, the USPS brief contains entire paragraphs that make undocumented assertions about the role of mean-centering in the evaluation of variability results, but it cites no authoritative source. Postal Service Initial Brief at V-113. Nelson explicitly cited problems in using Bradley's mean-centering approach when he adopted a simpler model specification. Tr. 28/13412. Bradley, as a rebuttal witness, had every opportunity to provide formulae or references to the econometric literature to document the correctness of his procedure, but did not and could not.

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institutional.

<sup>16</sup> NAA and OCA also argue that the ES-based variability estimates are wrong because they do not properly attribute coverage-related load time. As detailed in the Joint Reply Brief, their contention is incorrect. Even if this criticism were reasonable, a minor adjustment to the ES estimates can solve this problem.

- Bradley reasons that inter-BMC variabilities should be high, but ignores his own testimony (in the context of power-only contracts) that trailers account for a very small percentage of costs. See USPS-T-18 at 24. On contracts using less-than-maximum size vehicles, this enables capacity increments to be achieved at low incremental cost. Bradley's bias toward high variability is substantiated by the effect of his scrubs, which, as the Post Office admits, "in most instances" increased the resulting variabilities. Postal Service Initial Brief at V-115; USPS-T-18 at 24-25.
- Bradley believes that cross-sectional differences between contracts in terms of cost and capacity that result from differences in the number of runs are reflective of the changes that will occur within individual contracts as volume levels change. Postal Service Initial Brief at V-119; Tr. 43/18387. Nelson's models and Bradley's RWP-2 models show that a much lower variability emerges when the models properly account for the role of less-than-maximum size vehicles.<sup>17</sup>
- While the Postal Service criticizes Nelson for assuming that the variability of cubic-foot miles with respect to volume is one (Postal Service Initial Brief at V-120), all would have to admit that each of the highway variability models presented in the case (including Nelson's and both of Bradley's) have overstated variability because they do not include a multiplicative factor that is known to be less than one.

As we stated in our initial brief (at 31-34), the only results available to the Commission that are based on a sound analytical foundation for evaluating variability are Mr. Nelson's original results and Bradley's refinement of these results as presented in his RWP-2. The RWP-2 models introduced by Bradley avoid the cross-sectional bias and evaluation method infirmities of Bradley's initial models, while adopting and introducing potentially meritorious refinements

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<sup>17</sup> Periodicals Mailers earlier provided a formula for approximating highway variabilities using the refinements suggested by witness Bradley in his RWP-2 models. See Periodicals Mailers initial brief at 34, n. 16. For the Commission's ease of reference, the results of these calculations are attached to this reply brief. The calculations involve two steps. First, the variabilities provided by Bradley are run through the computations shown in Tables 2-7 of Nelson's Workpaper WP-4. This merges the model results, which apply only to the smaller vehicles, with the assumed 100 percent variability applicable to the largest capacity vehicles. The resulting values are then input to the Workpaper B-14 spreadsheet appearing in library reference USPS-LR-I-80. This results in

to the models Nelson presented. The Commission should accept these as the best models on the record for measuring the variability of purchased highway transportation costs.

#### **IV. THE TEST YEAR PERIODICALS COSTS SHOULD NOT BE INFLATED BY A CONTINGENCY FACTOR**

Periodical Mailers both joined in the initial brief of DMA, *et al.*, on the subject of revenue requirement, including contingency, and further focused on the appropriate contingency allowance to be assessed the Periodicals class at pages 50-59 of the Periodicals Mailers initial brief. We there showed that there is no support for a contingency allowance of 2.5 percent, as requested by the Postal Service, and that the appropriate contingency allowance for general applicability is one percent if FY 1998 data are used for the base year and .25 percent if FY 1999 data are used.

However, Periodicals Mailers also showed that, based upon the testimony of William Morrow and in the unique circumstances of this case, it is necessary to take the unprecedented but fully justified step of assessing the reasonableness of the system-wide contingency for particular classes. On the basis of this assessment, it is appropriate to eliminate the contingency allowance from the calculation of Periodicals test year costs, an exercise that could (depending upon the overall level of contingency) provide significant relief to Periodicals mailers with *de minimis* impact on the Postal Service's bottom line.

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an aggregate variability of 67.7 percent, producing savings for Periodicals of approximately \$35 million in comparison with the BY98 models.

This, of course, is a reply brief, and Periodicals Mailers expected to be in the position of replying to the Postal Service's opposition to Morrow's proposal (which it ignored in its rebuttal testimony). But we cannot, because the Postal Service has once again seen fit to ignore testimony that was neither cross-examined nor rebutted.<sup>18</sup> We submit that little if any weight should be given to arguments that the Postal Service (or any other party) might make for the first time in a reply brief, given that it has had and passed up several opportunities to question or respond to Morrow's proposal at a time when the issue could be fairly joined.

Perhaps the Postal Service's failure to address Morrow's proposal is part of its overall plan on the contingency issue. While our initial brief expressed surprise that the Postal Service's evidentiary defense of its contingency request was ineffectual, we are incredulous at the scant attention—a mere eight pages in a brief not otherwise characterized by brevity—it now pays to this \$1.6 billion issue. Apart from referencing the Strasser rebuttal testimony, the Postal Service rests its case on the assertion (Postal Service Initial Brief at II-4) that “there are uncertain times ahead” for the Postal Service, citing specifically the threat of electronic diversion. Were the Commission charged with estimating revenues and costs in FY 2010 instead of FY 2001, this concern would be real, but that is not the job facing the Commission. Rather the Commission must determine an appropriate “uncertainty” factor for a test year that is about to begin for an entity

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<sup>18</sup> The Postal Service's claim (Initial Brief at II-9) that Strasser “provided detailed testimony” rebutting the testimony of participants' witnesses proposing an alternative contingency allowance is not true in the case of Morrow's testimony; Strasser did not mention it.

that made a profit in its Docket No. R97-1 test year (FY 98), a profit the following year and perhaps even this year.

Moreover, the enumerated list (Postal Service Initial Brief at II-6-7) of eleven phrases uttered or cited by witnesses Tayman, Strasser and Zarnowitz in support of \$1.6 billion is not sullied by any analysis or explanation (and leaves the Postal Service a mere 9,989 reasons short of the "myriad" it claims can be found in the record (Postal Service Initial Brief at II-7)). Periodicals Mailers will rely upon the separate brief of DMA, *et al.*, to address these contentions.<sup>19</sup>

We will note here, however, because we addressed this legal issue in our initial brief (at 58), that the Postal Service has *not* challenged the Commission's authority to reduce the contingency request under the *Newsweek*<sup>20</sup> doctrine, although it has used that case to oppose cost disallowance based upon an asserted failure by the Postal Service to operate with "honest, efficient and economical management." Accordingly, all parties appear to agree that the Commission may reduce the contingency request if that request is deemed to be excessive based upon the record evidence. As Periodicals Mailers, other intervenors and OCA have shown, it should do so.

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<sup>19</sup> The Postal Service has not identified the "competitors' legislative efforts," one of these eleven factors, but it occurs to Periodicals Mailers that, given the Postal Service's track record with non-postal products, any legislation prohibiting such activity should reduce the need for a contingency.

<sup>20</sup> *Newsweek Inc. v. United States Postal Service*, 663 F. 2d 1186 (2d Cir. 1981), *aff'd sub nom. National Ass'n of Greeting Card Pubs. v. United States Postal Service*, 462 U.S. 810 (1983).

## **V. RATE DESIGN**

In this part, Periodicals show that the Commission should adopt both the mail flow model and the modest discount for some 5-digit pallets proposed by Periodicals Mailers.

### **A. The Stralberg/Glick Versus the Yacobucci Flats Mail Flow Model**

The Postal Service's initial brief praises the flats mail flow model presented by witness Yacobucci and describes at length the modifications Yacobucci made to the Docket No. R97-1 model of witness Seckar. But not one word is mentioned about the considerable shortcomings in Yacobucci's model identified by witnesses Stralberg and Glick. Nor is there any mention of the much improved model presented by Stralberg and Glick as MPA-LR-2. The Postal Service has filed no rebuttal to the improved model or to any of the critiques expressed by Stralberg and Glick. It apparently believes it can simply pretend that the improved model in MPA-LR-2 does not exist.

The Commission should use the MPA-LR-2 flats model, because it provides much more accurate estimates of the savings produced by presortation and pre-barcoding of flats. This information will allow the Commission to design rates that are more cost based and therefore more suited to encourage efficient mailer behavior.

**B. The Postal Service's Objections to a 5-Digit Pallet Discount Are Perplexing**

The Postal Service's objection to even a token incentive for mailers to produce more 5-digit pallets is disappointing, given the strong desire for more such pallets among field managers (Tr. 24/11405).

Curiously, one objection refers to the fact that Time Warner witness O'Brien (TW-T-2) discussed in his testimony a broader concept, "the grid," which would set rates based on both container type and presort level in addition to package presort and automation compatibility. No one has proposed full implementation of a grid-based rate design in this docket, but a 5-digit pallet discount would be a step in that direction and is perfectly consistent with the wider concept described by O'Brien.

The Postal Service argues that "pallet discounts have been controversial in past Commission proceedings," but ignores the following:

- a. Both the Postal Service and the Commission have in the past favored discounts for all pallets. The past controversies mostly concerned distance-related aspects of those more general discounts that are irrelevant to the present proposal.
- b. Periodicals mailers who in the past had sharp disagreements regarding the general issue of pallets versus sacks are in this docket in agreement concerning the type of discount proposed by Stralberg.
- c. Stralberg took special care to formulate his proposal in a way that would be acceptable to the Postal Service. He limited it to pallets entered at the DSCF or DDU to avoid any concern about cross docking many small pallets at ADCs and transfer hubs. He also specified that it would be restricted to pallets meeting all Postal Service make-up regulations, including regulations that the Postal Service may write in the future.

The Postal Service also argues that “in the current application of nonautomation rates, pallets receive an implicit discount because they receive package-based rather than container-based rates.” Postal Service Initial Brief at VII-146. But this too is irrelevant, since Stralberg demonstrates that 5-digit pallets save at least two cents per piece relative both to 3-digit pallets and 5-digit sacks, the two competing ways of carrying carrier route presorted flats bundles. Tr. 11407-09.<sup>21</sup> It is also by far the safest way, since bundles on 5-digit pallets have practically no chance of breaking prematurely.

For all the above reasons, and those expressed in our direct brief and in TW-T-1, the Commission should establish a 5-digit pallet discount in this docket, as an important step towards more cost based rates that will encourage efficient mail preparation.

## **VI. CONCLUSION**

For the reasons stated above, in Periodicals Mailers’ initial brief, and in the other initial and reply briefs in which Periodicals Mailers have joined, the

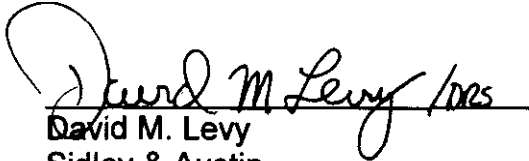
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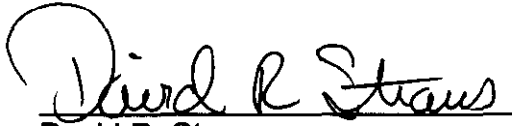
<sup>21</sup> Stralberg also shows the same to be true for 5-digit bundles carried on 5-digit pallets.

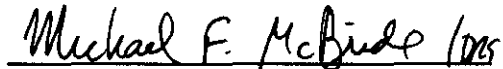



Commission should recommend rate increases for the Periodicals subclasses  
that do not exceed the average percentage increase recommended.


Respectfully submitted,


  
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John M. Burzio (vs)

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Timothy L. Keegan  
Burzio & McLaughlin  
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Washington, DC 20007-4403  
For Time Warner, Inc.

Stephen M. Feldman (vs)

Stephen M. Feldman  
601 Pennsylvania Avenue, NW  
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Washington, DC 20004  
for Coalition of Religious Press  
Associations

September 22, 2000

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the following document upon all participants in this proceeding in accordance with section 12 of the Rules of Practice.

David R. Straus

David R. Straus

## ATTACHMENT

Summary of Results Regarding Analysis  
of  
Purchased Highway Transportation Volume Variability

Account Type	Accrued Cost	Volume Var. Cost – USPS BY98	Volume Var. Cost - Nelson	Volume Var. Cost – Bradley RWP-2
Intra-SCF	780,882	501,814	350,327	392,552
%		0.643	0.449	0.503
Inter-SCF	451,826	409,337	350,340	337,754
%		0.906	0.775	0.748
Intra-BMC	272,745	268,989	171,348	214,066
%		0.986	0.637	0.785
Inter-BMC	264,390	259,271	79,855	250,008
%		0.981	0.302	0.946
Plant Load	45,685	41,025	9,228	32,071
%		0.898	0.202	0.702
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Total Highway	1,838,700	1,500,532	976,651	1,244,330
%		0.816	0.531	0.677